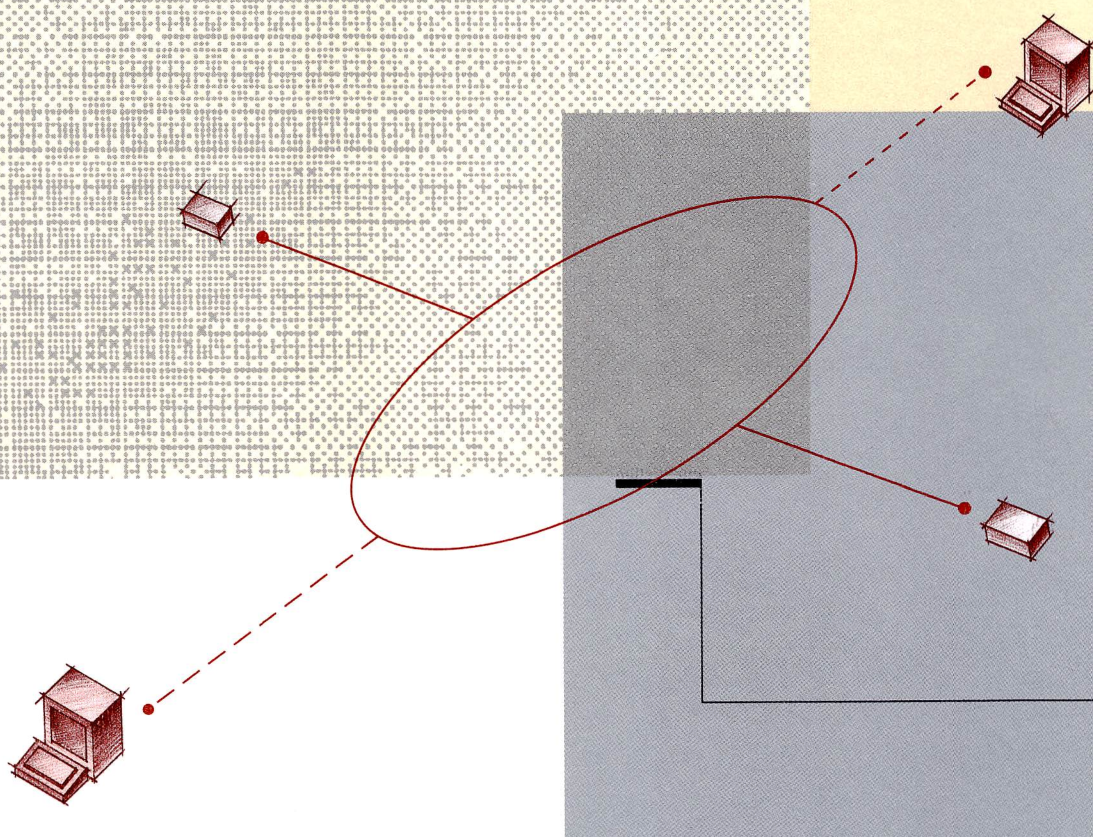
WE SOLVE NETWORK PROBLEMS

Network General Corporation

ANNUAL REPORT



1991

About the Company

Network General Corporation is a leading supplier of software-based tools and systems that help troubleshoot and manage local and wide area networks. > The need for network troubleshooting and management products is becoming increasingly significant in organizations of all sizes. This is due primarily to the growing size and complexity of networks, and their mission-critical nature which results in the burgeoning costs of network slowdowns and failures. > As specialists in the business of network analysis, Network General is well-positioned to participate in the market's rapid growth. Because the Company provides tools for networks of all major types, it is uniquely able to serve the needs of a wide variety of organizations.

Financial Highlights

(In thousands, except share amounts)

	1991	1990	1989	1988
Revenues	$44,613	$29,421	$12,864	$4,911
Net income	$ 7,261	$ 5,912	$ 2,563	$ 832
EPS	$ .50	$ .43	$ .26	$ .11
Headcount at Year end	148	82	39	15

Revenues

Net Income

Earnings per Share

"Such systems as Network General's Sniffer are indispensable distant-early-warning tools, alerting the network manager to incoming missiles. Those boxes are priceless diagnostic tools for untangling what went wrong, simulating network loads, and watching for what breaks, when, and why." Jim Seymour, PC Magazine

Business Highlights

> **April 3, 1990.** The Watchdog Network Monitor is introduced.

> **May 15, 1990.** Network General launches a series of network troubleshooting training courses for LAN professionals.

> **May 29, 1990.** Network General becomes an IBM Business Partner with the introduction of the Series 700 IBM PS/2-based Sniffer Network Analyzer and the availability of 16/4 Mbps Token Ring analysis technology, using state-of-the-art, IBM-manufactured Token Ring boards.

> **June 6, 1990.** Harry Saal, president and CEO of Network General, is named the Bay Area 1990 Software Entrepreneur of the Year by Ernst & Young.

> **June 14, 1990.** 2-for-1 stock dividend is announced.

> **August 20, 1990.** Sniffer Version 3.0 is released featuring enhanced SNMP support.

> **October 2, 1990.** The Sniffer Wide Area Network (WAN) Analyzer is introduced.

> **October 29, 1990.** The industry's first advanced monitoring for 16/4 Mbps Token Ring LANs is introduced.

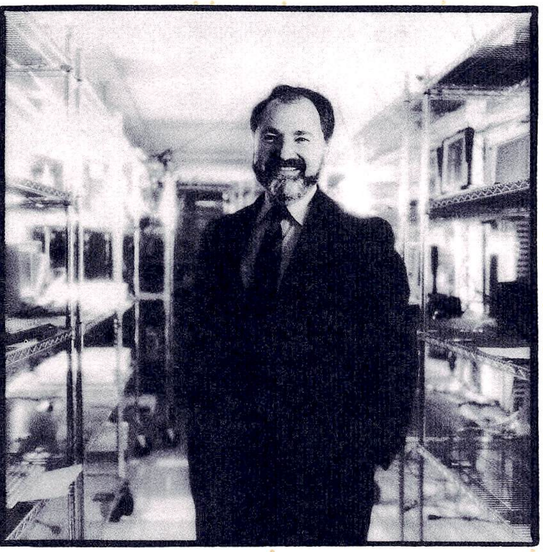
> **November 5, 1990.** Network General expands the senior management team with the appointment of Kees Bruin as general manager of Network General Europe, S.A., and Riley Willcox as chief financial officer. Morey Schapira is named general manager of Asia/Americas operations, and Jim Pante is promoted to director of U.S. sales.

> **November 29, 1990.** Acquisition of manufacturer's representative organization, David Brown Associates, Inc. of Atlanta, Georgia.

> **March 27, 1991.** Jay Weil is appointed vice president of marketing.

> **March 28, 1991.** Distributed Sniffer System is introduced.

Letter to Shareholders



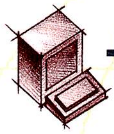
"Network General's Sniffer has come to be known as the quintessential network protocol analysis tool..."

John Fratus et al., PC Week

For Network General, fiscal 1991 resulted in our fifth straight year of significant revenue and profit growth. It was also the fifth year of our ongoing commitment to providing network managers with valuable tools and systems for solving costly, complex network problems. > We believe there are five key reasons for Network General's remarkable success:

> **FOCUSED VISION.** We continue to pursue the same vision we had in 1986 when we pioneered seven-layer protocol analysis for local area networks (LANs). We do this by building on available technology—making it more versatile, more advanced ("smarter") and easier to use. This results in a range of products that are benefits-oriented with high customer value.

> **LEADING-EDGE PRODUCTS.** As competition in the market has increased, we have responded by introducing leading-edge products that address the rapidly changing market for new technologies. For example, this past year we added 16Mbps Token Ring and wide area network (WAN) topologies to our family of Sniffer Network Analyzers. > In March, 1991, we introduced our most important product since the original Sniffer Network Analyzer: the Distributed Sniffer System. The Distributed Sniffer System was developed in response to the growing demand for centralized monitoring and analysis of geographically dispersed, enterprise-wide networks.



Using the same client-server architecture as today's networks, the Distributed Sniffer System allows our customers to leverage scarce network management resources.

> **Customer Responsiveness.** We also build success from our relationships with our customers. Since our goal is making the network manager's job easier, we listen carefully to them, try to anticipate their needs, and then fulfill them. About a year ago, we heard our customers asking for troubleshooting training courses. Our response was to develop a training organization that has expanded both geographically and quantitatively in course offerings. This kind of responsiveness forges strong customer relationships and contributes to our overall success. > Recent evidence of our success with this focus on our customers appears in a 1991 Dataquest study, which gave Network General 44% of the domestic protocol analysis market. A December, 1990 Prognostics study on customer loyalty found that a truly remarkable 92% of Network General's customers indicate they would continue to purchase our products: this contrasts with a software industry average of 77%.

> **Motivated Employees.** We build success through our employees. Our significant growth has required almost doubling personnel over this past year. Concurrent with this growth, Network General has devoted considerable effort to maintaining company culture. Our culture can be best described as a supportive, "can do" attitude which results in a high degree of teamwork within the Company. We are especially proud of our exceptional productivity, as evidenced by our industry-leading average revenue-to-employee ratio of over $367,000:1.

> **Willingness to Deal with Mistakes.** While all companies are justly proud of their successes, they often try to hide their miscalculations and continue on a failed course of action long after the failure is apparent. Network General's response to the failure of the Watchdog Network Monitor to meet expectations perhaps says more about our corporate character than our many accomplishments. When the product did not achieve what we believed was its revenue potential, we quickly changed the sales channel and marketing strategy. By October, we had rechanneled the product through existing sales rep organizations, redirected our product marketing effort to reach a more appropriate audience, and, in a matter of months, the Watchdog monitor was successfully on a new track.

> We have many people to thank for helping make 1991 a successful year, including our customers, our employees and our stockholders who have continued to support the Company in all of its efforts. > We are confident that we have met the challenges of fiscal year 1991, and we look forward to the coming year with enormous anticipation. As the networking market grows, we will do our best to continue building on the successes that have made Network General the undisputed leader in helping people solve their network problems.

Harry J. Saal
CEO, President and
Chairman of the Board
Network General Corporation

Translating Customer Needs Into Market Opportunities

The essence of Network General's product strategy is to provide practical, workable solutions and services that make the job of today's corporate network manager manageable. > Currently, the network manager is under siege—too little time, too little support from within, lack of sufficient knowledge, and yet responsible for a critical corporate resource. This state of "crisis" in the world of network management has created a demand for dynamic, easy-to-use tools that leverage the manager's resources.

> **Evolution of Networks.** In the 1950's and 1960's, networking as a concept was in the earliest stages of development. The technology was based on timesharing among large, centralized mainframe computers. Most failures could be easily traced to a central CPU. By the late 1960's, homogeneous networks (i.e., SNA, DECnet) had come to dominate the computer industry. These hierarchical networks gave users even more freedom to communicate and share information, yet still had minimal failure rates due to the proprietary nature of the hardware and software. > The personal computer revolution created an entirely new kind of network—the local area network (LAN). The initial surge of homegrown networks slowly evolved into today's LANs consisting of a wide choice of PCs and workstations, sophisticated cabling and communication schemes, and server technology that provide the services necessary to make networks an effective computing alternative to mainframes and minicomputers. Local area networks were enthusiastically installed, helter-skelter fashion, usually at the departmental level. The single most attractive feature of these proliferating networks was the computing power now in the hands of each user. Rather than dealing with large, centralized mainframe computers accessed by dumb terminals, individual users now owned a share of the organization's computing resource. The general robustness of these local area networks, however, "masked" specific failures in the system, and therefore, management of these networks was performed on an ad hoc basis.

> **Networks Today.** As networks become more pervasive and complex, incorporating both local and wide area networks, the problems of interoperability, performance, management and troubleshooting grow exponentially. The responsibility for keeping these mission-critical systems up and running efficiently falls squarely on the shoulders of network managers who are often ill-equipped to deal with the enormity of the task. Each time a network slows down or fails completely, the costs in lost business and lost productivity run into the hundreds of thousands or even millions of dollars.

> **Who's in Charge?** It is not unusual for corporations to spend less than 1% on maintenance and management of local area networks. For a $7 million investment in networking, only $60,000 is spent to keep them up and running. Since networks are not typically a corporate level purchase, and because they are a shared resource, responsibility is frequently fragmented, with no one person or group in charge. Additionally, the issues surrounding local area networks and network management are not well understood by senior management, leaving a serious communication gap.

> **Understanding the Network Manager's Plight.** Network General's value to the network manager is in providing tools and support services that help get the job done. Without the proper tools, network managers are faced with costly trial and error troubleshooting when the system fails. > Our products allow network managers to "look" inside their networks, monitor performance proactively and quickly solve network problems. > Network General products save time, money and valuable human resources by putting powerful tools into the network managers' hands. > As specialists in the business of network troubleshooting and optimization, Network General is well-positioned to lead the network manager out of a state of chaos.

"The training was a '10'. I now have a much better understanding of the Sniffer, the things it can and cannot do for me, and what I will be able to do with the Sniffer when I return to work."

Pacific Bell

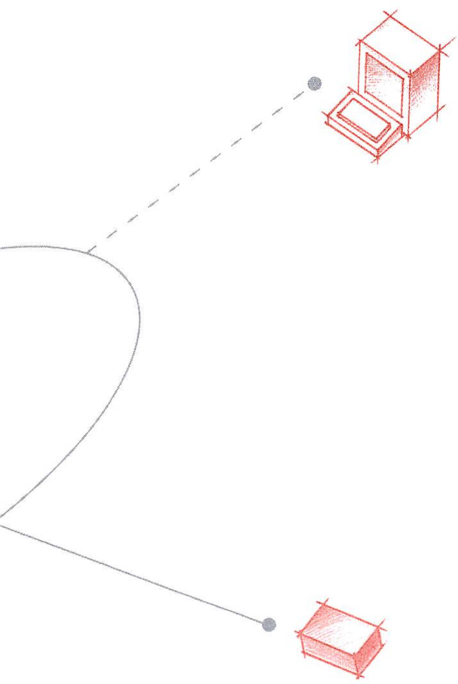
Network General's Training Program

Network professionals constantly face technological changes and ever-increasing complexity in their work. Yet, in today's business enterprise, the demands for interoperability and seamless, transparent networked communication are not an option. They are a necessity. > Equally urgent is the need for skilled employees in the fields of local area network management, systems integration and design. However, enterprises find it increasingly difficult to locate people with skills to integrate a variety of equipment in multivendor network environments. > This is why Network General is committed to providing the network professional with education on the problems and complexities of network integration and growth, expansion into advanced technologies, maintenance, troubleshooting and performance optimization. > In support of this commitment to the network manager, Network General has established the industry's most comprehensive training program for network analysis and methods for solving network problems. Network General believes that by sharing the company's expertise, we can help customers become self-sufficient in running their networks and add value to the tools and systems they use. > The Company's training program is tightly focused to provide a large return to the customer on time invested. All courses teach network troubleshooting using practical, real-life problems. When students return to their offices, they often find themselves facing the same types of problems that they have just learned how to solve in our classroom. > "I have debugged several network problems since taking the class. If I had taken the class earlier, it would have cut my analysis time down and taken the guesswork out of my job. Thanks Network General!"—Southwestern Bell. Another goal of the program is to teach methodologies to measure network baselines, so that students can determine what is normal on their own networks. This baseline analysis methodology strongly encourages proactive network management. > "Even though I've had a Sniffer for two years, this course has helped me polish my skills, and it has helped me to look at multiple protocol packets to see what's normal and unusual on a network."—Abbott Labs. "Hands-on" involvement is a third important component of the program, and Network General maintains a 1:1 ratio of students to equipment in most classes. > Finally, the entire training program is based on accumulated knowledge and expertise that Network General has acquired in network problem solving. This knowledge is probably the most valuable resource that we share with our customers.

NASA

At NASA's Kennedy Space Center in Florida, reliability of the maze of computer networks is essential to the success of the nation's space program. > Just ask Al Purrinos, network manager responsible for one of NASA's three major networks. Degradation of the network, which often comes in the form of traffic overload, slowness, or even downtime, can create headaches of stratospheric proportions for Purrinos and his staff of network administrators. Purrinos manages the center's Kennedy Data Networks (KDN), which serve more than 2,000 users who depend on KDN to support space program projects. Purrinos oversees all network applications, consolidation and configuration, as well as internetworking communications and wide area network links to other Kennedy Space Center networks. > For Purrinos and his organization, having the proper tools to monitor and troubleshoot the networks is essential to their efficient operation. Without the right tools to diagnose the KDN, network failures can create real nightmares and impact applications such as office automation, project management, engineering and communications. > To ensure that performance of the KDN is optimized, the Space Center uses the Sniffer Network Analyzer. KDN has continued to grow over the years and has become increasingly more complex, more multivendor, more interconnected and more sophisticated. Within this changing environment, the Sniffer Network Analyzer has facilitated orderly growth of the network and has provided solutions to numerous network performance problems. > A typical problem the Sniffer analyzer helped solve is illustrated in a case where a user was unable to communicate with a host computer experiencing network downtime. "The situation was becoming a major problem and impacting the individual's ability to support a space station project," recalls Purrinos. > The downtime occurred when the user attempted to access vital information at the host computer located at NASA's Johnson Space Center in Houston. Using the Sniffer Network Analyzer, Purrinos found that in order to connect to the Houston computer, the user had to access a 56Kbps transmission line across four bridges and

> *“With the Sniffer… problems that previously took hours to identify now are located in minutes.”*
>
> Al Purrinos, NASA

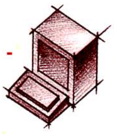


through a router, a scheme designed to facilitate the flow of information across interconnected networks. Sniffer data showed that the user's Ethernet local area network was being utilized at a rate of 40 percent, an amount considered excessive. When the user tried to access the host through the bridges, information overload on one of the bridges caused that bridge to disconnect the user. > The Sniffer analyzer let Purrinos pinpoint the problem and resolve it quickly. After looking further into the problem with the Sniffer analyzer, Purrinos decided to transfer the user to another local area network closer to the host. This eliminated the need to cross multiple bridges and resolved the downtime problem. > Without the Sniffer analyzer, Purrinos would have had to segment the network and analyze it piece by piece—a time-consuming process. Like a doctor without an X-ray machine, he would have had to rely on trial and error to find and correct the problem. “With the Sniffer, you can see inside the network. Problems that previously took hours to identify now are located in minutes,” he said. > The Sniffer analyzer not only is used to solve problems after they occur, but also is an effective prevention tool. “Without a doubt, early diagnosis is often the key to avoiding network crisis,” Purrinos added.

The Weather Channel

Every day, millions of people across the United States tune in to The Weather Channel[1] to get up-to-date information on whether it's going to rain or shine. From airline pilots to farmers in the field, from corporate travelers to a family planning a picnic, people have come to rely on the cable channel to get the latest forecast before starting their day. > The Weather Channel, headquartered in Atlanta, Georgia, is a 24-hour, all weather satellite network that distributes local, regional, national and international weather information to 48 million homes via 4,300 cable affiliates. > But just as viewers depend on The Weather Channel for their meteorological information, the Channel depends on a complex collection of computer systems to make it all work. An important part of its operations is the Advanced Weather Graphics (AWG) local area network (LAN). > The AWG LAN system is designed to receive large amounts of meteorological data such as satellite, radar, graphic imagery and text data. This data is then analyzed, forecasts are made and, finally, the information is used to create and

> *Downtime of the Weather Channel Lan is unacceptable. If we have a failure... I have to be able to get the network back up by literally, now.*
>
> Lanelle Johnson, The Weather Channel



display on-air meteorological maps, satellite images and radar loops for television viewers. The reliability of this network is absolutely critical and this is where the Sniffer Network Analyzer plays a strategic role. > Lanelle Johnson, manager of the AWG LAN, states that the network performs a mission-critical task, and has to be up and running smoothly around the clock. To ensure this, the Sniffer analyzer operates non-stop, 24 hours a day, to proactively monitor the network and pinpoint incipient problems before they lead to failure. > Johnson states that any downtime of the AWG LAN is unacceptable. "If we have a failure, I can't say I have to have the AWG network back up in three to four hours. That's not going to cut it. I have to be able to get the network back up by literally, now." > The Weather Channel utilizes on-line system redundancy and continuous network monitoring to ensure the earliest detection of system problems. The Sniffer analyzer, says Johnson, plays an invaluable role in ensuring that the AWG LAN runs consistently. It is used as a proactive network management tool that alerts her to events that can disrupt the AWG LAN. Johnson also likes the Sniffer analyzer's ability to monitor the AWG LAN 24 hours a day. Even when she's at home, Johnson stays connected to the AWG LAN through TeleSniffer, a feature which allows her to monitor the network remotely. > With the criticality of information moving through the AWG LAN, Johnson appreciates the Sniffer analyzer's ability to provide her a total picture of network activity. This gives her the peace of mind that operations will always be dependable, and that The Weather Channel will continue to be the place people can turn to for the most timely and accurate weather information.

[1]The Weather Channel is a subsidiary of Landmark Communications, Inc., a Norfolk, Virginia based corporation with interests in publishing, broadcasting and cable television.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Revenues.

	1991	Change	1990	Change	1989
Revenues	$ 44,613	52%	$ 29,421	129%	$ 12,864
Gross Profit	34,619	57%	22,027	125%	9,780
Percentage of revenues	78%		75%		76%
Operating Expenses	25,511	84%	13,855	140%	5,784
Percentage of revenues	57%		47%		45%
Net Income	$ 7,261	23%	$ 5,912	131%	$ 2,563
Earnings per share	$ .50	16%	$ .43	65%	$ .26

The Company has experienced substantial growth in revenues since product shipments began in September, 1986. Results for successive years reflect increased market acceptance of the Company's Sniffer network analysis products and services and expansion of the Company's marketing and sales efforts. Substantially all the Company's revenues to date have been derived from the sale of LAN analysis products. Monitoring products introduced in early fiscal year 1991 are a small portion of the Company's revenues. Related services are a small but growing component of revenues.

This discussion addresses operations for fiscal years 1991, 1990 and 1989. Comparisons for the most recent two fiscal years are more meaningful than comparisons with activities in fiscal year 1989, due to the fact that the Company's operations were substantially smaller in 1989.

Fiscal year 1991 revenues were 52% greater than prior year revenues, compared to revenue growth of 129% from fiscal year 1989 to 1990. The reduced rate of revenue growth reflects increase in the revenue base as the Company moved from start-up to more mature levels of operations.

Sales to international distributors were 23%, 19% and 16% of revenues in fiscal 1991, 1990 and 1989, respectively. During fiscal 1991, the Company reorganized its sales operations and created separate divisions for Europe and Asia/Americas with general managers for each division. In fiscal 1991, Network General Europe, established in Brussels, Belgium in late fiscal 1990, was expanded to include technical support.

Gross Profit.

Costs of revenues consist of direct product costs, manufacturing expenses and services expenses. Gross profit as a percentage of revenues has varied from period to period primarily due to changes in the relative proportions of international and domestic sales, as well as changes in product mix and configurations. Gross profit for the fiscal year ended March 31, 1991 was 57% greater than gross profit for the year ended March 31, 1990, compared to a growth of 125% between fiscal 1990 and 1989. Gross profit as a percent of revenues increased to 78% in fiscal 1991, compared to 75% in fiscal 1990 and 76% in fiscal 1989. The higher gross profit percentage for the year ended March 31, 1991 reflects a greater portion of higher-margin, board-level product sales and increases in the average number of software options shipped per Sniffer Network Analyzer. This greater portion of board-level products resulted from both faster growth in international sales, which are nearly all of this configuration, and a modest increase in its portion of domestic sales.

Marketing and Sales Expenses.

	1991	Change	1990	Change	1989
Marketing and sales	$ 18,427	86%	$ 9,883	153%	$ 3,910
Percentage of revenues	41%		34%		30%

Marketing and sales expenses for the year ended March 31, 1991 were 86% greater than marketing and sales expenses for the year ended March 31, 1990, compared to a 153% increase between fiscal 1989 and 1990. Marketing and sales expenses were 41%, 34% and 30% of revenues for the fiscal years 1991, 1990 and 1989, respectively. The increase in

marketing and sales expenses as a percent of revenues during fiscal 1991 is due to several factors. First, the Company incurred increased expenses in connection with launching the Watchdog Network Monitor in the first quarter of fiscal 1991 and with introduction of the Distributed Sniffer System in the fourth quarter of fiscal 1991. A second factor was the previously discussed expansion of sales and marketing staff to develop international markets. Finally, new customer training programs and enlarged lead generation programs added to marketing expenses.

Research and Development Expenses.

	1991	Change	1990	Change	1989
Research and development	$ 3,407	82%	$ 1,873	107%	$ 907
Percentage of revenues	8%		6%		7%

Research and development expenses for fiscal year 1991 were 82% greater than fiscal year 1990, compared to a 107% increase between fiscal 1989 and 1990. The Company believes that continued investment in product development is required in order to remain competitive. Research and development expenses consist primarily of salaries and benefits, occupancy expenses, fees paid to outside consultants, and selected expenses related to acquisition of new technologies. Research and development expenses were 8%, 6% and 7% of revenues for the fiscal years 1991, 1990 and 1989, respectively. The increase in research and development expenses during fiscal year 1991 was in large part due to additional salaries and benefits as the Company expanded its research and development staff.

Research and development expenses are accounted for in accordance with FASB Statement No. 86, under which the Company is required to capitalize software development costs after technological feasibility is established. Capitalizable software development costs incurred to date have not been significant, and thus the Company has charged all software development costs to expense in the consolidated statements of operations.

General and Administrative Expenses.

	1991	Change	1990	Change	1989
General and administrative	$ 3,677	75%	$ 2,099	117%	$ 967
Percentage of revenues	8%		7%		8%

General and administrative expenses consist primarily of salaries and benefits, occupancy expenses, legal and accounting fees, and bad debt expenses. General and administrative expenses increased 75% between fiscal 1990 and fiscal 1991, compared to an increase of 117% between fiscal 1989 and fiscal 1990. General and administrative expenses were 8%, 7% and 8% of revenues for the fiscal years 1991, 1990 and 1989 respectively. During fiscal 1991, general and administrative expenses increased primarily due to the establishment of a Human Resources department and increased bad debt expenses, much of which was related to a change in the distribution of the Watchdog Network Monitor product.

Interest Income.

	1991	Change	1990	Change	1989
Net interest income	$ 1,576	10%	$ 1,430	422%	$ 274
Percentage of revenues	4%		5%		2%

Net interest income increased 10% for the year ended March 31, 1991, compared to the year ended March 31, 1990. Proceeds from two public offerings of the Company's Common Stock are the source of funds generating this income. The Company's initial public offering was effective February 2, 1989 and its second offering was effective August 2, 1989. Interest income fluctuates due to several factors, including the general level of interest rates, the Company's investment balances, and the mix between tax-exempt and taxable investments. Generally, the Company invests in tax-free investment instruments.

PROVISION FOR INCOME TAXES.

	1991	Change	1990	Change	1989
Provision for income taxes	$ 3,423	−7%	$ 3,690	116%	$ 1,707
Effective tax rate	32%		38%		40%

As a percentage of pretax income, the provision for income taxes was 32%, 38% and 40% for the fiscal years 1991, 1990 and 1989, respectively. The 1991 rate decrease reflects tax benefits derived from the Company's Foreign Sales Corporation, research and development tax credits, and partial investment in tax-exempt investments of proceeds from the Company's two public offerings of Common Stock.

LIQUIDITY AND CAPITAL RESOURCES.

	1991	Change	1990	Change	1989
Cash, cash equivalents and short term investments	$ 16,423	−24%	$ 21,722	67%	$ 13,007
Working capital	$ 37,093	23%	$ 30,235	110%	$ 14,378
Cash generated by operations	$ 5,030	9%	$ 4,615	260%	$ 1,281
Cash provided by (used in) investment activities, excluding short term investments	$ (10,948)	−411%	$ 3,525	132%	$ (10,882)
Cash provided by financing activities	$ 619	−95%	$ 12,126	25%	$ 9,678

Net cash provided by operating activities was $5.0 million for the year ended March 31, 1991, compared to $4.6 million and $1.3 million for the years ended March 31, 1990 and 1989, respectively. The increase for fiscal year 1991 was largely due to higher operating income and the accumulation of deferred revenues, partially offset by increases in working capital.

Year-to-year changes in cash equivalents are largely due to the movement of funds between marketable securities and investments classified as cash equivalents. The Company used approximately $11 million in investing activities during the year ended March 31, 1991, $8.2 million of which was the transfer of investments classified as marketable securities from those classified as cash equivalents. In 1990 the investing activities provided $3.5 million, with a $6.6 million decrease in marketable securities. In fiscal year 1991 the Company used $2.8 million to acquire capital equipment, compared to $3.1 million in fiscal 1990 when the Company moved into its new headquarters.

Overall the Company's cash and cash equivalents decreased $5.3 million for the year ended March 31, 1991, compared to a $20.2 million increase in fiscal 1990 and less than $0.1 million increase in fiscal 1989. Comparisons to prior years are somewhat distorted because of stock offerings in each of the prior years that generated $12.1 million and $9.7 million, respectively.

As of March 31, 1991, Network General's principal source of liquidity included cash, cash investments, and marketable securities of approximately $29.6 million. The Company currently has no outstanding borrowings and has no established bank lines of credit. The Company believes that current cash investments, together with existing sources of liquidity and anticipated funds from operations, will satisfy projected working capital and capital expenditure requirements at least through fiscal 1992.

Selected Financial Data

Consolidated Statement of Operations Data

(In thousands, except per share data)

	Year Ended March 31				Inception (May 15, 1986) to March 31
	1991	1990	1989	1988	1987
Revenues	$ 44,613	$ 29,421	$ 12, 864	$ 4,911	$ 556
Income from operations	9,108	8,172	3,996	1,427	2
Net income	7,261	5,912	2,563	832	—
Earnings per share	.50	.43	.26	.11	—
Weighted average common and common equivalent shares outstanding	14,505	13,704	10,074	7,806	6,552

Consolidated Balance Sheet Data

(Dollars in thousands)

	March 31				
	1991	1990	1989	1988	1987
Working capital	$ 37,093	$ 30,235	$ 14,378	$ 2,663	$ (26)
Total assets	45,398	36,658	16,959	4,514	341
Long-term obligations and redeemable preferred stock	222	62	77	2,043	25
Total stockholders' equity	40,988	33,108	15,070	2,829	10

Quarterly Financial Data (Unaudited)

(In thousands, except per share and stock price amounts)

	Mar. 31, '91	Dec. 31, '90	Sept. 30, '90	June 30, '90	Mar. 31, '90	Dec. 31, '89	Sept. 30, '89	June 30, '89
Revenues	$11,841	$12,092	$10,677	$10,003	$ 8,774	$ 8,037	$ 7,120	$ 5,490
Gross profit	9,368	9,435	8,106	7,710	6,779	5,966	5,228	4,054
Income from operations	2,252	2,743	1,729	2,384	2,355	2,316	1,931	1,570
Income before provision for income taxes	2,641	3,158	2,103	2,782	2,695	2,769	2,300	1,838
Net income	$ 1,874	$ 2,116	$ 1,467	$ 1,804	$ 1,712	$ 1,685	$ 1,412	$ 1,103
Earnings per share	$ .13	$ .15	$ .10	$ .12	$ .12	$ .12	$ .10	$ .09
Price range common stock	$ 12.25- $ 7.00	$ 9.00- $ 5.00	$ 14.50- $ 4.25	$ 13.38- $ 11.00	$ 13.63- $ 9.38	$ 10.75- $ 8.19	$ 10.25- $ 6.50	$ 6.82- $ 5.25

Consolidated Balance Sheets

Years ended March 31 (Dollars in thousands, except per share amounts)	1991	1990
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 16,423	$ 21,722
Marketable securities	13,200	5,000
Accounts receivable, net of allowance for doubtful accounts of $297 in 1991 and $183 in 1990	7,522	5,088
Inventories	2,006	1,256
Prepaid expenses and other current assets	2,130	657
Total current assets	41,281	33,723
Property and Equipment, at cost:		
Demonstration and rental equipment	2,794	1,645
Office and development equipment	3,448	1,917
Leasehold improvements	380	335
	6,622	3,897
Less-Accumulated depreciation and amortization	(2,936)	(1,147)
Net property and equipment	3,686	2,750
Other Assets, net	431	185
	$ 45,398	$ 36,658
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 1,101	$ 1,155
Accrued liabilities	2,162	1,834
Income taxes payable	—	352
Deferred revenue	892	48
Customer deposits	33	99
Total current liabilities	4,188	3,488
Long-Term Customer Deposits	—	62
Non-Current Deferred Taxes	222	—
Commitments (Note 4)		
Stockholders' Equity:		
Preferred stock—$.01 par value		
Authorized—2,000,000 shares		
Outstanding—none	—	—
Common Stock—$.01 par value		
Authorized—50,000,000 shares		
Outstanding—14,228,032 shares in 1991 and 14,150,732 shares in 1990	142	140
Additional paid-in capital	24,302	23,685
Retained earnings	16,544	9,283
Total stockholders' equity	40,988	33,108
	$ 45,398	$ 36,658

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Operations

For the three years ended March 31
(Dollars in thousands, except per share amounts)

	1991	1990	1989
Revenues	$ 44,613	$ 29,421	$ 12,864
Cost of Revenues	9,994	7,394	3,084
Gross Profit	34,619	22,027	9,780
Operating Expenses:			
Marketing and sales	18,427	9,883	3,910
Research and development	3,407	1,873	907
General and administrative	3,677	2,099	967
	25,511	13,855	5,784
Income from Operations	9,108	8,172	3,996
Interest Income, net	1,576	1,430	274
Income Before Provision for Income Taxes	10,684	9,602	4,270
Provision for Income Taxes	3,423	3,690	1,707
Net Income	$ 7,261	$ 5,912	$ 2,563
Earnings Per Share	$ .50	$ .43	$ .26
Weighted Average Common and Common Equivalent Shares Outstanding	14,505,000	13,704,000	10,074,000

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

For the three years ended March 31 (Dollars in thousands, except per share amounts)	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Total
BALANCE, MARCH 31, 1988	7,508,000	$ 53	$ —	$ 808	$ 861
Initial public offering of common stock at $4.00 per share, net of issuance costs of $1,146	2,706,000	38	9,640	—	9,678
Conversion of mandatorily redeemable preferred stock into common stock	2,185,658	33	1,935	—	1,968
Net income	—	—	—	2,563	2,563
BALANCE, MARCH 31, 1989	12,399,658	124	11,575	3,371	15,070
Public offering of common stock at $7.63 per share, net of issuance costs of $949	1,681,000	16	11,853	—	11,869
Issuance of common stock under the Employee Stock Purchase Plan at $3.40 and $5.53 per share	24,584	—	108	—	108
Issuance of common stock for services rendered	41,820	—	134	—	134
Exercise of stock options at $4.00 per share	3,670	—	15	—	15
Net income	—	—	—	5,912	5,912
BALANCE, MARCH 31, 1990	14,150,732	140	23,685	9,283	33,108
Issuance of common stock under the Employee Stock Purchase Plan at $6.80 and $9.14 per share	28,680	1	222	—	223
Exercise of stock options at $4.00 - $6.38 per share	36,972	1	155	—	156
Issuance of common stock for services rendered, net	11,648	—	240	—	240
Net income	—	—	—	7,261	7,261
BALANCE, MARCH 31, 1991	14,228,032	$142	$24,302	$16,544	$40,988

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the three years ended March 31 (In thousands)	1991	1990	1989
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$ 7,261	$ 5,912	$ 2,563
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	1,812	1,029	285
Provision for doubtful accounts	390	136	70
Deferred taxes	222	—	—
(Increase) decrease in assets			
Accounts receivable	(2,824)	(3,097)	(1,160)
Inventories	(750)	(522)	(495)
Prepaid expense and other current assets	(1,473)	(335)	(188)
Other assets	(246)	(169)	2
Increase (decrease) in liabilities			
Accounts payable and accrued liabilities	274	1,577	539
Income taxes payable	(352)	7	(392)
Deferred revenues	844	48	—
Customer deposits	(128)	29	57
Net cash provided by operating activities	5,030	4,615	1,281
CASH FLOWS FROM INVESTING ACTIVITIES			
(Increase) decrease in marketable securities	(8,200)	6,551	(10,051)
Purchase of property and equipment	(2,837)	(3,138)	(831)
Sale of rental equipment	89	112	—
Net cash provided by (used in) investing activities	(10,948)	3,525	(10,882)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issuance of common stock, net of issuance costs	619	12,126	9,678
Net cash provided by financing activities	619	12,126	9,678
Net increase (decrease) in cash and cash equivalents	(5,299)	20,266	77
Cash and Cash Equivalents at Beginning of Period	21,722	1,456	1,379
Cash and Cash Equivalents at End of Period	$ 16,423	$ 21,722	$ 1,456

The accompanying notes are an integral part of these consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 1991

1. OPERATIONS

Network General Corporation (the "Company") designs, markets and supports software-based network analysis tools for a broad spectrum of physical connection technologies and communications protocols. The Company was incorporated in 1986 as a California corporation and changed its state of incorporation to Delaware in fiscal 1988.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation. The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, after elimination of intercompany accounts and transactions.

Reclassifications. Certain balances in the 1990 financial statements have been reclassified to conform to the 1991 presentation.

Revenues. The Company recognizes product revenues upon shipment of the systems or software. Revenues on rental units under operating leases and service agreements are recognized ratably over the term of the rental or service period. Payments received in advance under such contracts are recorded as deferred revenues. Royalty income is recognized based on the number of copies of software sold by the licensees of the software products. Revenues on software development contracts with certain OEM customers are recognized based on milestones specified in the contracts.

No single customer accounted for more than 10% of revenues in fiscal 1991, 1990 or 1989. Export sales as a percentage of revenues consist of:

	1991	1990	1989
Europe	14%	11%	9%
Asia/Americas	9%	8%	7%
Total Export Sales	23%	19%	16%

Cash and Cash Equivalents. For purposes of the consolidated statements of cash flows, the Company includes cash in banks, certificates of deposits, commercial paper, money market funds and municipal notes, with an original maturity date of three months or less to be cash equivalents.

The Company paid approximately $4,129,000, $3,844,000 and $2,229,000 in income taxes in fiscal 1991, 1990 and 1989, respectively (see Note 7). Amounts paid for interest were insignificant.

Marketable Securities. Marketable securities have maturities greater than three months but less than one year, and are carried at the lower of cost or market. As of March 31, marketable securities consist of (in thousands):

	1991	1990
Municipal notes and floaters	$ 5,700	$ —
Money market preferred stock	7,500	5,000
	$ 13,200	$ 5,000

Inventories. Inventories are stated at the lower of cost (first in, first out) or market and include material, labor and related manufacturing overhead. As of March 31, inventories consist of (in thousands):

	1991	1990
Purchased parts	$ 1,321	$ 872
Work-in-process	—	228
Finished goods	685	156
	$ 2,006	$ 1,256

Property and Equipment. Property and equipment are depreciated and/or amortized using the straight-line method over the following estimated useful lives:

Classification	Life
Demonstration and rental equipment	2 years
Office and development equipment	3 years
Leasehold improvements	Lease term

Software Development Costs. The Company anticipates capitalizing eligible computer software development costs upon the establishment of technological feasibility, which the Company has defined as completion of a working model. As of March 31, 1991 costs which were eligible for capitalization were insignificant and, thus, the Company has charged all software development costs to expense in the accompanying consolidated statements of operations.

Earnings Per Share. Earnings per share is computed using the weighted average number of shares of common and common equivalent shares resulting from dilutive convertible preferred stock in 1989 and options outstanding during the applicable periods. Fully diluted earnings per share is the same as primary earnings per share.

3. Accrued Liabilities

As of March 31, accrued liabilities consist of the following (in thousands):

	1991	1990
Accrued compensation and related taxes	$ 815	$ 630
Accrued commissions	729	680
Other accrued expenses	618	524
	$ 2,162	$ 1,834

4. Commitments

The Company leased certain equipment under operating lease agreements during fiscal 1990 and 1989 from a company that is wholly owned by two officers and shareholders of the Company. During fiscal 1990, the Company purchased the remainder of the equipment under lease for approximately $77,000. Payments of approximately $185,000 and $134,000 were paid to this leasing company in fiscal 1990 and 1989, respectively.

The Company also leases its facilities and certain other equipment under operating lease agreements. As of March 31, 1991, minimum future lease payments under these operating leases are as follows (in thousands):

Fiscal year	
1992	$ 988
1993	217
1994	117
1995	9
1996	9
1997 and thereafter	43
	$ 1,383

Total rent expense was approximately $822,000, $359,000 and $285,000 in fiscal 1991, 1990 and 1989, respectively.

5. Employee Savings Plan

In September 1988, the Board of Directors approved an employee savings plan (the "Plan") which is intended to be qualified and exempt from tax under section 401(K) of the Internal Revenue Code. Under the Plan, employees may elect to contribute up to 15% of their gross compensation. The Company contributes to the Plan in amounts determined at the discretion of the Board of Directors. All contributions by the Company are funded currently and vest ratably over three years. All employee contributions are fully vested. Amounts provided by the Company under the plan to date have not been material.

6. Common Stock

The Company consummated an initial public offering of its common stock at $4.00 per share in February 1989. In connection with this offering, all mandatorily redeemable preferred stock outstanding at that time was converted into common stock on a one-for-one basis.

In August 1989, the Company completed a second public offering of its common stock at $7.63 per share.

In August 1990, the Company completed a two-for-one stock split effected in the form of a stock dividend. Prior year share and per share data have been adjusted to reflect the stock split.

Stock Option Plans. Under the Company's 1989 Stock Option Plan, key employees, employee directors and consultants may be granted either incentive or non-qualified options to purchase common stock at the discretion of the Board of Directors. The Company has reserved a total of 2,000,000 shares for issuance under this plan. The exercise price of the stock options may not be less than the fair market value of the common stock on the date of the grant for incentive options or less than 85% of the fair market value of the common stock on the date of grant for non-qualified options. Generally, all options either vest ratably over a three year period or in a lump sum amount at the end of four years.

Option activity under the plan since inception is summarized as follows:

	Available for Grant	Outstanding	Price Per Share
Initial Authorization	500,000	—	—
Granted	(172,000)	172,000	$4.00-$5.09
Balance as of March 31, 1989	328,000	172,000	$4.00-$5.09
Authorization Increase	1,000,000	—	—
Granted	(418,800)	418,800	$5.94-$12.24
Cancelled	14,000	(14,000)	$4.00-$5.94
Exercised	—	(3,670)	$4.00
Balance as of March 31, 1990	923,200	573,130	$4.00-$12.24
Authorization Increase	500,000	—	—
Granted	(1,174,510)	1,174,510	$4.00-$11.75
Cancelled	428,764	(428,764)	$4.00-$12.24
Exercised	—	(36,972)	$4.00-$6.38
Balance as of March 31, 1991	677,454	1,281,904	$4.00-$12.24

During fiscal 1991, the Company cancelled 401,200 options at $4.57 to $12.24 per share and reissued the same number of options at $4.38 per share.

Of the outstanding options, 64,708 options were exercisable as of March 31, 1991.

In April 1989, the Company established the 1989 Outside Directors Stock Option Plan, whereby outside directors may be granted non-qualified options to purchase common stock. 360,000 shares of common stock were reserved for issuance under this plan. The exercise price of the stock option may not be less than the fair market value of the common stock on the date of the grant. Generally, all options vest over a three year period.

Each outside director is granted an option of 60,000 shares upon election to the Board and an additional 10,000 shares each subsequent year. As of March 31, 1991, 210,000 options have been granted and were outstanding at $5.25 to $12.63 per share and 60,000 shares were exercisable at $5.25 per share.

Stock Purchase Plan. The Company has reserved 300,000 shares of common stock for issuance under the 1989 Employee Stock Purchase Plan. Employees may elect to withhold up to 10% of their compensation for the purchase of the Company's common stock. The amounts withheld are used to purchase the Company's common stock at a price equal to 85% of the fair market value of the stock on the first or last day of a six-month offering period, whichever is lower. The Company issued 28,680 shares at an average price of $7.78 per share in 1991 and 24,584 shares at an average price of $4.39 per share in 1990.

Stock Award Plan. In June 1989, the Board of Directors approved the 1989 Common Stock Award Plan and reserved 120,000 shares for issuance thereunder. Under this plan, awards are made to independent sales representatives and consultants based upon individual sales performance criteria. The shares are issued at fair market value and the related costs of the shares are charged to expenses. The shares generally vest over three years and the Company can reacquire any unvested shares upon termination of the individual's relationship with the Company. As of March 31, 1991, 29,468 shares have been awarded under this plan, of which 9,823 shares are vested.

As of March 31, 1991 the Company has the following shares of common stock reserved for future issuance:

1989 Stock Option Plan	1,959,358
1989 Outside Directors Stock Option Plan	360,000
1989 Stock Purchase Plan	246,736
1989 Stock Award Plan	90,532
	2,656,626

7. Income Taxes

The Company has elected early implementation of the provisions of Statement of Financial Accounting Standards No. 96 "Accounting For Income Taxes." Income before provision for income taxes and the components of the provision for income taxes consist of the following (in thousands):

	1991	1990	1989
Income (loss) before provision for income taxes:			
Domestic	$ 10,596	$ 9,602	$ 4,270
Foreign	88	—	—
	$ 10,684	$ 9,602	$ 4,270

	1991	1990	1989
Provision for income taxes:			
Federal			
Current payable	$ 3,073	$ 2,900	$ 1,440
Deferred tax asset	(712)	(128)	(138)
Non-current deferred	187	—	—
	2,548	2,772	1,302
State			
Current payable	804	918	405
Non-current deferred	35	—	—
	839	918	405
Foreign	36	—	—
Total Provision	$ 3,423	$ 3,690	$ 1,707

The sources of deferred tax assets are as follows:

	1991	1990	1989
Reserves and accruals not currently deductible for tax purposes	$ 368	$ 112	$ 28
State taxes, not currently deductible for Federal tax purposes	32	174	81
Depreciation	90	(167)	—
Other	—	9	29
	$ 490	$ 128	$ 138

The provision for income taxes differs from the amounts obtained by applying the Federal statutory rate to income before taxes as follows:

	1991	1990	1989
Statutory Federal income tax rate	34.0%	34.0%	34.0%
State income taxes, net of Federal benefit	5.0	6.6	5.8
Permanent differences	(7.4)	(4.7)	—
Other	0.4	2.5	0.2
	32.0%	38.4%	40.0%

Report of Independent Public Accountants

To Network General Corporation:

We have audited the accompanying consolidated balance sheets of Network General Corporation (a Delaware corporation) and subsidiaries as of March 31, 1991 and 1990, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended March 31, 1991. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Network General Corporation and subsidiaries as of March 31, 1991 and 1990, and the results of their operations and their cash flows for each of the three years in the period ended March 31, 1991 in conformity with generally accepted accounting principles.

Arthur Andersen & Co.

San Jose, California
April 22, 1991

Corporate Information

Board of Directors

Harry J. Saal
Chairman of the Board
President and
Chief Executive Officer

Leonard J. Shustek
Executive Vice President,
Secretary

Michael C. Child[2]
Partner, TA Associates

Gregory M. Gallo[2]
Member, Ware & Freidenrich

Laurence R. Hootnick[2]
President and Chief Executive
Officer, Maxtor Corporation

[2]Member of Audit Committee

Officers

Harry J. Saal
Chairman of the Board
President and Chief Executive
Officer, Director

Roger C. Ferguson
Chief Operating Officer

Leonard J. Shustek
Executive Vice President,
Research and
Development, Secretary,
Director

Riley R. Willcox
Vice President, Finance
Chief Financial Officer

George E. Comstock
Vice President,
Business Development

Jay Weil
Vice President, Marketing

Legal Counsel

Ware & Freidenrich
Palo Alto, CA 94301

Independent Public Accountants

Arthur Andersen & Co.

Inquiries Concerning Network General

If you have questions concerning Network General's operations, recent results, or historical performance, or if you wish to receive Network General's 1991 Annual Report, 1991 Form 10-K, or press releases, all of which are available without charge, please contact:

Investor Relations
Network General Corporation
4200 Bohannon Drive
Menlo Park, CA 94025
415/688-2700

Inquiries Concerning the Stock

If you have questions concerning stock certificates, change of address, consolidation of accounts, transfer of ownership, or other stock account matters, please contact Network General's stock transfer agent:

Bank of America
Stock Transfer Services
P.O. Box 37002
Dept 9527
San Francisco, CA 94137
415/624-4100

Common Stock

Network General's common stock is traded on the NASDAQ National Market System under the symbol NETG. As of May 3, 1991, there were 254 stockholders of record.

Dividend Information

On June 14, 1990, Network General declared a 100% stock dividend for stockholders of record at the close of business on August 3, 1990. The Company confirmed payment of the dividend on August 20, 1990 and the stock began trading on a post-dividend basis on August 21, 1990.

Network General Corp.

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Menlo Park, CA 94025

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Network General